

# **CALIFORNIA LOTTERY**

Report of Analysis

## **RESULTS UNDER AB 142**

*For the Fiscal Year 2012-13*



**JOHN CHIANG**  
California State Controller

January 2014



**JOHN CHIANG**  
**California State Controller**

January 9, 2014

Members of the California State Legislature  
State Capitol Building  
Sacramento, CA 95814

Dear Senators and Assembly Members:

I am pleased to provide you with the State Controller's analysis of the California Lottery results under Assembly Bill (AB) 142 for fiscal year (FY) 2012-13.

Our review determined that the event described in Government Code section 8880.4.5(c)(2) occurred. After the enactment of AB 142, the annual average of total Lottery net revenues allocated to the benefit of public education from the California State Lottery Education Fund, at the end of FY 2012-13, is less than the total net revenues of the last full fiscal year prior to the enactment of AB 142, adjusted for annual growth.

As only one of the events described in GC section 8880.4.5(c) occurred, sections 8880.4, 8880.63, and 8880.64 will remain in effect at least until the next analysis is performed for FY 2013-14.

Questions regarding the report should be directed to my Chief Operating Officer, George Lolas, by phone at (916) 552-8080.

Sincerely,

*Original signed by*

**JOHN CHIANG**  
California State Controller

JC/kw

cc: Paula D. LaBrie, Acting Director  
California Lottery  
Nicholas Buchen, Deputy Director, Finance  
California Lottery  
Roberto Zavala, Chief Internal Auditor  
California Lottery  
John Smolin, Chairperson  
California Lottery Commission  
Gregory Ahern, Commissioner  
California Lottery Commission

Nathaniel Kirtman III, Commissioner  
California Lottery Commission  
Connie M. Perez, Commissioner  
California Lottery Commission

# Contents

**Report of Analysis**

**Summary** ..... 1

**Background** ..... 1

**Objectives, Scope, and Methodology** ..... 4

**Results** ..... 4

# Report of Analysis

## Summary

In accordance with Government Code section 8880.4.5, amended by the enactment of Assembly Bill (AB) 142, the State Controller's Office (SCO) performed an analysis to determine whether the events described in Government Code section 8880.4.5(c)(1) and (c)(2) occurred and whether the Controller shall report to the Governor and/or Legislature regarding the analysis. Subsection (b) requires the SCO to report to the Legislature and Governor if both of the events occurred. Subsection (c) requires the SCO to report only to the Legislature if either of the events occurred.

Our analysis found that the event described in Government Code section 8880.4.5(c)(2) occurred. Our determination is based on the following observations:

- The total net revenues allocated to the benefit of public education from the California State Lottery Education Fund (CSLEF) for fiscal year (FY) 2012-13 totaled \$1,260,789,450 and was not less than the total net revenues allocated to public education in the last full fiscal year prior to enactment of AB 142 (FY 2008-09), which totaled \$1,002,527,893, excluding interest income or investment proceeds.
- The annual average of total net revenues allocated to the benefit of public education from the CSLEF after enactment of AB 142 totaled \$1,219,951,982 and was less than the total net revenues for the last full fiscal year prior to the enactment of AB 142, adjusted for annual growth of lottery revenues, which totaled \$1,493,570,983.

As stated in section 8880.4.5, since only one of the events described in GC section 8880.4.5(c) occurred, the SCO is required to report the occurrence to the Legislature, and GC sections 8880.4, 8880.63, and 8880.64 will remain in effect at least until the next analysis is performed for FY 2013-14.

## Background

In 1984, California voters passed an initiative, which by amending the State Constitution, authorized a state-operated lottery. The initiative created the California State Lottery Act of 1984 (Lottery Act), which requires the quarterly transfer of net revenues to the public education community and established the allocation percentages of lottery funds. The Lottery Act also requires the SCO to conduct quarterly and annual post-audits of all accounts and transactions of the Lottery Commission and other special post-audits as the State Controller deems necessary.

The SCO conducts quarterly analyses of the Lottery's transfer of funds to the public education community. These analyses are a part of the SCO's responsibility under the Lottery Act.

Assembly Bill 142 amended the Lottery Act in April 2010. The Lottery Act now requires that not less than 87% of the total annual revenues be returned to the public. Not less than 50% of the total revenues, in an amount to be determined by the Lottery Commission, is to be returned to the public in the form of prizes. The Lottery Act also requires not more than 13% of the total revenues to be used for the Lottery expenses. In addition, the Lottery Act requires the Lottery Commission to establish the percentage to be allocated to the benefit of public education at a level that maximizes the total net revenues allocated to the public education community.

Fiscal year 2012-13 is the third of five full fiscal years after the enactment of AB 142. To ensure increases in Lottery net revenues allocated to public education, the Lottery Act requires the SCO to determine whether the following events occurred:

- The total net revenues allocated to the benefit of public education from the CSLEF are less than the total net revenues allocated to the benefit of public education in the last full fiscal year prior to the enactment of AB 142 (GC section 8880.4.5(c)(1)).
- The annual average of total net revenues allocated to the benefit of public education from the CSLEF after the enactment of AB 142 is less than the total net revenues allocated to the benefit of public education in the last full fiscal year prior to the enactment of AB 142, adjusted for an annual growth rate of 1.8% or the actual growth rate of lottery revenues since enactment of AB 142, whichever is greater (GC section 8880.4.5(c)(2)).

In June 2011, AB 363 further amended the amount of time the Controller has to prepare reports and convene a Lottery review group as required by AB 142. AB 363 requires the SCO to issue those reports by December 31 and March 31, respectively. AB 363 also extends the operation of the provisions described above until April 1 of the year following notification of the Legislature and the Governor by the SCO that the specified events have occurred.

Government Code Section 8880.4.5. states:

- (a) Following the end of each full fiscal year, the commission shall calculate and report to the Controller and to the Legislature the amount of total net revenues allocated to the benefit of public education from the California State Lottery Education Fund for that fiscal year.
- (b) To ensure increases in lottery net revenues allocated to public education, if in any one of the first five full fiscal years after the enactment of the act adding this section, the Controller determines that both of the events described in paragraphs (1) and (2) of subdivision (c) occur, then the Controller shall notify the Legislature and the Governor, and post that notification on the Controller's Internet Web site, and on January 1 of the following year, both of the following shall occur:

- (1) The amendments made to Sections 8880.4, 8880.63, and 8880.64 by the act adding this section shall become inoperative.
  - (2) Sections 8880.4, 8880.63, and 8880.64, as they existed prior to the effective date of the act adding this section shall become operative.
- (c) No later than December 31 following each of the first five fiscal years in which the amendments made by the act adding this section are in effect, the Controller shall report to the Legislature whether either of the following occurred in the prior fiscal year:
- (1) The total net revenues allocated to the benefit of public education from the California State Lottery Education Fund are less than the total net revenues allocated to the benefit of public education in the last full fiscal year prior to the enactment of the act adding this section.
  - (2) The annual average of total net revenues allocated to the benefit of public education from the California State Lottery Education Fund after the enactment of the act adding this section is less than the total net revenues allocated to the benefit of public education in the last full fiscal year prior to the enactment of the act adding this section, adjusted for an annual growth rate of 1.8 percent or the actual growth rate of lottery revenues since enactment of the act adding this section, whichever is greater.
- (d) If the conditions specified in subdivision (c) do not occur, then in subsequent fiscal years, to ensure continued growth in lottery net revenues allocated to public education, the commission, when setting the percentage required in subparagraph (A) of paragraph (2) of subdivision (a) of Section 8880.4, shall ensure that net revenues allocated to public schools are at least as much as were allocated on average in the prior five fiscal years, and increased in proportion to any upward increases in lottery net revenues.
- (e) At the end of the first five full fiscal years following enactment of the act adding this section, the Controller shall convene a lottery review group to consist of the Controller, the Superintendent of Public Instruction, and the chairperson of the commission. The review group shall report to the Legislature, no later than March 31 following the final fiscal year, on whether the amendments made by the act adding this section have furthered the purposes of the California State Lottery Act of 1984 as intended.
- (f) This section shall become inoperative on April 1 of the year following notification from the Controller to the Legislature and the Governor that the events described in paragraphs (1) and (2) of subdivision (c) have occurred, and as of the following January 1 is repealed, unless a later enacted statute, that is enacted before January 1 of that following year, deletes or extends the dates on which it becomes inoperative and is repealed.

## Objectives, Scope, and Methodology

We performed an analysis for FY 2012-13 to determine if the following events occurred:

- The total net revenues allocated to the benefit of public education from the CSLEF are less than the total net revenues allocated to the benefit of public education in the last full fiscal year prior to the enactment of AB 142.
- The annual average of total net revenues allocated to the benefit of public education from the CSLEF after the enactment of AB 142 is less than the total net revenues allocated to the benefit of public education in the last full fiscal year prior to the enactment of AB 142, adjusted for an annual growth rate of 1.8% or the actual growth rate of lottery revenues since enactment of AB 142, whichever is greater.

The scope of the analysis included, but was not limited to the following:

- Reviewing the amendments to the Lottery Act made by the enactment of AB 142 and AB 363;
- Reviewing the SCO's Reports of The Analysis: Quarterly Transfer of Funds to Public Education for the quarter ended June 30, 2009, June 30, 2010, June 30, 2011, June 30, 2012, June 30, 2013, and corresponding work papers; and
- Performing an analysis to determine whether the events described in Government Code section 8880.4.5(c)(1) and (c)(2) occurred.

## Results

We performed an analysis for FY 2012-13 to determine whether the events described in Government Code section 8880.4.5(c)(1) and (c)(2) occurred. We determined that the event described in subsection (c)(2) occurred.

The annual average of total net revenues allocated to the benefit of public education from the CSLEF after enactment of AB 142 totaled \$1,219,951,982 and was less than the total net revenues for the last full fiscal year prior to the enactment of AB 142, adjusted for annual growth, which totaled \$1,493,570,983.

The "annual average of total net revenues" is the average of net revenues of \$1,100,817,293 for FY 2010-11, \$1,298,249,204 for FY 2011-12 and \$1,260,789,450 for FY 2012-13. "Total net revenues" is lottery sales minus prizes and operating expenses. "Total net revenues adjusted for annual growth" is the last full fiscal year prior to the enactment of AB 142 adjusted for an annual growth rate of 1.8% or the actual growth rate of lottery revenues since enactment of AB 142, whichever is greater.



The actual growth rate is calculated by taking the current year total lottery revenues and subtracting the prior year total lottery revenues and dividing the difference by the prior year total lottery revenues. The adjusted total net revenues is calculated by multiplying the prior year adjusted total net revenues by either the current year actual growth or 1.8%, whichever is greater. The following table shows total net revenue amounts, actual growth rates, and adjusted total net revenue amounts since FY 2008-09:

Fiscal Year	Total Net Revenues	Actual Growth Rate	Statutory Rate	Adjusted Total Net Revenues
2008-09	\$ 1,002,527,893	N/A	N/A	N/A
2009-10	1,024,165,517	2.91%	1.8%	\$ 1,020,573,395
2010-11	1,100,817,293	13.08% <sup>1</sup>	1.8%	1,154,064,395
2011-12	1,298,249,204	27.13%	1.8%	1,467,162,066
2012-13	1,260,789,450	1.70%	1.8%	1,493,570,983

<sup>1</sup> The growth rate in FY 2010-11 was calculated using total net revenues. After further legal interpretation, we determined that actual growth rates should be calculated using total lottery revenues rather than total net revenues. However, this change did not affect the occurrence of the event described in GC section 8880.4.5(c)(2) in FY 2010-11.

As part of our analysis, we calculated the adjusted total net revenue of public education for FY 2012-13 by multiplying the prior fiscal year adjusted total net revenue of \$1,467,162,066 by (1 + 1.8%). Since the actual growth rate of 1.7% is less than the statutory growth rate of 1.8%, we used the statutory growth rate as directed in subparagraph (c)(2).

Since only one of the events described in section 8880.4.5(c) occurred, sections 8880.4, 8880.63 and 8880.64 will remain in effect at least until the next analysis is performed for FY 2013-14.

**State Controller's Office  
Division of Audits  
Post Office Box 942850  
Sacramento, CA 94250-5874**

**<http://www.sco.ca.gov>**